No. 87-1097

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES,
Petitioner,

v.

GEORGETOWN UNIVERSITY HOSPITAL, *et al.*
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF IN OPPOSITION

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QUESTION PRESENTED

Whether the Secretary of Health and Human Services may validly apply a retroactive Medicare cost limit rule to recoup from respondents monies that he previously paid them as a result of a final court judgment.

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BRIEF IN OPPOSITION

STATUTES AND REGULATIONS INVOLVED

1. 5 U.S.C. § 551(4)—Appendix ("App.")[1] at 67a.
2. 5 U.S.C. § 553(b)-(d)—App. at 67a-68a.
3. 5 U.S.C. § 706—App. at 68a.
4. 42 U.S.C. § 1395x(v)(1)(A) (section 1861(v)(1)(A) of the Social Security Act)—App. at 69a-70a.
5. Pub. L. No. 92-603, § 223(b) (1972)—App. at 70a.
6. 42 C.F.R. § 413.9(b)(1)—App. at 70a-71a.
7. 42 C.F.R. § 413.30(a), (b)(3)—App. at 71a.
8. 42 C.F.R. § 413.64(a)(1), (b), (f)—App. at 71a-73a.

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[1] Pages 1a-66a of the Appendix will be found in the Secretary's petition. Later numbered pages are appended hereto.

STATEMENT OF THE CASE

The court of appeals' opinion accurately recounts the key facts of this case. App. at 2a-10a. Respondents furnish the following additional background regarding the statutory and regulatory framework.

The Medicare statute (title XVIII of the Social Security Act) was enacted in 1965. Pub. L. No. 89-97, § 102(a) (1965). It required that hospitals furnishing services to Medicare beneficiaries be reimbursed their "reasonable cost." 42 U.S.C. §§ 1395f(b), 1395x(v)(1)(A). It mandated that the Secretary's implementing regulations "take into account both direct and indirect costs" so that non-Medicare patients would not subsidize costs properly attributable to Medicare patients and Medicare would not subsidize costs properly attributable to non-Medicare patients. 42 U.S.C. § 1395x(v)(1)(A)(i); *Northwest Hospital, Inc. v. Hospital Service Corp.*, 687 F.2d 985, 991 (7th Cir. 1982). It also mandated that the Secretary's regulations "provide for the making of suitable retroactive corrective adjustments where, for a provider of services for any fiscal period, the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive" (42 U.S.C. § 1395x(v)(1)(A)(ii))—referred to by the court of appeals as the "retroactive corrective adjustments provision" (App. at 6a n.5).

The Secretary published implementing regulations a year later. 31 Fed. Reg. 14,808 (1966). They provided that the "reasonable cost" reimbursement standard is "intended to meet . . . actual costs, however widely they may vary from one institution to another . . . subject to a limitation where a particular institution's costs are found to be substantially out of line with other institutions in the same area which are similar in size, scope of services, utilization, and other relevant factors." 20 C.F.R. § 405.451(c)(2) (1966). They construed the retroactive corrective adjustments provision as simply requiring a year-end settling of accounts reflecting the difference between what a provider is entitled to after a full audit of its cost report for a particular year and the amount of estimated payments

that it received during the year. *See* 20 C.F.R. § 405.454(f) (1966), redesignated 42 C.F.R. § 413.64(f) (App. at 72a-73a); 20 C.F.R. § 405.451(b)(1) (1966), redesignated 42 C.F.R. § 413.9(b)(1) (App. at 70a-71a); 20 C.F.R. § 405.454(a), (b) (1966), redesignated 42 C.F.R. § 413.64(a)(1), (b) (App. at 71a-72a).

Over time, Congress concluded that the original payment standard failed to provide proper incentives for efficiency and economy. H.R. Rep. No. 92-231, 92d Cong., 1st Sess. 82-85 (1971), Joint Appendix ("J.A.") [2] at 70-73; S. Rep. No. 92-1230, 92d Cong., 2d Sess. 187-190 (1972), J.A. at 74-77. It was also concerned that the Secretary's disallowance authority was too limited. *Id.* Accordingly, it amended the Medicare statute in 1972 to allow the Secretary to establish prospective cost limits. Pub. L. No. 92-603, § 223(b) (App. at 70a).

In 1974, the Secretary published a regulation to implement the authority to establish Medicare cost limits conferred on him by section 223(b) of the 1972 amendments. 39 Fed. Reg. 20,164 (1974). Consistent with the statutory language and the legislative history, the regulation specified that cost limits "will be imposed prospectively. . . ." 20 C.F.R. § 405.460(a) (1974), redesignated 42 C.F.R. § 413.30(a)(2) (App. at 71a).

Pursuant to that regulation, the Secretary published in 1974 his first schedule of limits applicable to "routine costs." [3] He thereafter published an annual schedule of routine cost limits for the next seven years. The last of these was the 1981 schedule, which applies only to hospital cost reporting years beginning in the period July 1, 1981 through September 30, 1982. 46 Fed. Reg. 33,637 (1981). In late 1984, the Secretary published the retroactive wage index rule at issue here as an after-the-fact component of the *1981* schedule of limits. 49 Fed. Reg. 46,495 (1984).

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[2] The Joint Appendix referred to in this brief was filed by the parties with the court of appeals.

[3] "Routine costs" include "regular room, dietary, and nursing services, and minor medical and surgical supplies." 42 C.F.R. § 413.53(b)(2).

SUMMARY OF ARGUMENT

The Secretary's petition should be denied for seven reasons.

First, this case involves unprecedented governmental overreaching. The Secretary promulgated and applied a retroactive rule to recoup from the respondents funds previously paid to them as a result of a final court judgment. He has openly acknowledged using retroactive rulemaking rather than the normal appeals process established by law to reverse the court decision. The district court and the court of appeals dealt with the Secretary's overreaching in an appropriate and, under the circumstances, very restrained manner.

Second, the Secretary's retroactive Medicare *cost limit* rule is invalid because the authorizing statutory provision (section 223(b) of the Social Security Amendments of 1972) and the accompanying congressional reports prohibit the Secretary from issuing retroactive *cost limit* rules. The prospectivity requirement is also plainly reflected in the Secretary's cost limit regulation, prior cost limit schedules, and administrative decisions.

Third, the broad construction of the retroactive corrective adjustments provision presented in the Secretary's petition is simply a *post hoc* rationalization of the Secretary's counsel that conflicts with the plain wording of the provision itself and the construction in the Secretary's own long-standing regulations. Moreover, even if the broad construction of the Secretary's counsel were generally correct, it would not assist the Secretary here. With respect to Medicare *cost limit* rules, the express prospectivity requirement established by section 223(b) would override the very general retroactive corrective adjustments provision.

Fourth, the court of appeals' Medicare holding does not conflict with the holding of any other circuit. No circuit has ever held that the Secretary may promulgate a retroactive *cost limit* rule. The recapture of accelerated depreciation cases cited by the Secretary, all decided in the 1970s, are not on point because they did not involve either a *cost limit* rule or a rule with significant (much less, as here, *total*) retroactive effect.

Fifth, the Medicare issue raised by the Secretary has virtually no current relevance or financial impact. There have been *no* Medicare cost limits applicable to *any* hospital in the country since October 1, 1983.

Sixth, the Administrative Procedure Act ("APA") question raised by the Secretary is not properly presented here. Because section 223(b) bars a retroactive cost limit rule, this Court need not consider whether the APA *also* bars the Secretary's retroactive rule. Moreover, the court of appeals' holding that, as a "general rule," the APA prohibits retroactive rulemaking is in accord with the APA's plain language, the accompanying legislative history, and prior decisions of this Court and other appellate courts. None of the cases cited by the Secretary involves circumstances even remotely similar to those here.

Seventh, affirmance of the judgment below does not require consideration of either of the questions presented by the Secretary. The district court's judgment is based on an entirely independent and discrete ground. The district court also implied agreement with four other discrete grounds advanced by the respondents.

ARGUMENT

The Court should deny the Secretary's petition for the seven reasons discussed below.

1.a. This case is unique. The Secretary's 1984 retroactive wage index rule apparently marks the first and only time that an administrative agency has applied a retroactive rule to recoup moneys previously paid by the agency as a result of a final court judgment. It also apparently marks the first and only time that an agency has by its own admission attempted to reverse a lower court judgment not through the appeals process but through retroactive rulemaking.

In *District of Columbia Hospital Association v. Heckler*, No. 82-2520 (D.D.C. Apr. 29, 1983) (App. at 49a-66a) (hereinafter, *DCHA*), the court invalidated the Secretary's 1981 wage index rule because the Secretary failed to promul-

gate the rule in accordance with the mandatory notice and comment procedures of the APA. The court expressly denied the Secretary's request to stay invalidation pending promulgation of a new rule utilizing notice and comment procedures.[4] App. at 60-61. It stated that an "unlawfully promulgated regulation should be invalidated *ab initio*" (App. at 63a), that "invalidation of the 1981 wage index and formula would leave in place the formula that was arrived at after proper notice and comment procedures and was used successfully to reimburse providers prior to July 1981" (App. at 61a), and that "[i]f the Secretary wishes to put in place a valid *prospective* wage index, she should begin proper notice and comment proceedings" (App. at 64a (emphasis added)). The Secretary did not appeal.

Following the *DCHA* decision, the Secretary paid the respondents for their *1981* years in accordance with the pre-existing 1979 wage index rule. However, more than a year and a half after *DCHA* became final, he applied his 1984 retroactive wage index rule to recoup from the respondents the monies he had previously paid them as a result of *DCHA*.[5] *The reopening notices issued by the Secretary's agents stated that the recoupment was "based on a reversal" of the DCHA decision effected through the Secretary's retroactive rulemaking. See, e.g.,* J.A. at 68, 69. The Secretary has also acknowledged in his filings with this Court that he used retroactive rulemaking as a substitute for appealing the adverse *DCHA* decision.[6] For sheer agency arrogance, this case is without precedent.

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[4] The court found that none of the conditions for granting such relief was present. App. at 60a-61a.

[5] *DCHA* became final on September 1, 1983. The Secretary's retroactive wage index rule was not published until November 26, 1984, and not applied to recoup funds previously paid to the respondents until April 1985.

[6] *See* Application for an Extension of Time Within Which to File a Petition for a Writ of Certiorari at 2 ("*Rather than appeal* [*DCHA*], the Secretary decided to resolve this matter through a new rulemaking proceeding that would make the new rule retroactive to the date of the original modification." (Emphasis added.)); Pet. at 11-12 ("When [the 1981 rule] was invalidated by the district court on procedural grounds in 1983, *the Secretary decided not to appeal that determination; instead*—after subjecting the regulation to prior notice and comment—*she reissued the regulation in 1984 and gave the revalidated regulation the same 1981 effective date as the original regulation.*" (Emphasis added.)).

b. The Secretary states that "[i]f an agency cannot retroactively correct even an insignificant procedural error, the government will be forced to seek review of many more adverse lower court decisions in order to protect the agency's regulatory authority." Pet. at 25. The Secretary's threat is based on the false premise that lower courts are likely to invalidate agency rules because of an "insignificant procedural error"; but under the APA "prejudicial error" rule (5 U.S.C. § 706 (final sentence)), they are not likely to do so. And if they do, the Secretary obviously should seek to reverse the decisions through the appeals process established by law rather than through vigilante retroactive rulemaking.

To the extent that the Secretary is suggesting that the failure to follow the notice and comment procedures mandated by the APA is an "insignificant procedural error," the Secretary is clearly mistaken. This Court has recognized the significance of these procedures and the duty of the courts to enforce compliance by federal agencies. *Chrysler Corp. v. Brown,* 441 U.S. 281, 303, 313, 316 (1979); *NLRB v. Wyman-Gordon Co.,* 394 U.S. 759, 765 (1979). The Secretary's retroactive rule has "trivialized" (App. at 37a) and made "a mockery of the provisions of the APA" (App. at 14a). As the court of appeals noted, "[o]bviously, agencies would be free to violate the rulemaking requirements of the APA with impunity if, upon invalidation of a rule, they were free to 'reissue' that rule on a retroactive basis." App. at 14a.

Moreover, if the Secretary can apply a "second-chance" retroactive rule against the respondents, what is to prevent him from imposing a "third-chance" retroactive rule if the "second-chance" retroactive rule fails or from imposing a "fourth-chance" retroactive rule if the "third-chance" retroactive rule fails? By repeatedly repromulgating retroactive wage index rules, the Secretary could engage respondents and the courts in endless litigation over respondents' *1981* Medicare reimbursement. Forcing respondents to continue to relitigate this matter for a cost reporting year long since past, as the Secretary creates new retroactive rules and new retroactive rulemaking records, is inconsistent with basic notions of justice and fair play and wasteful of judicial resources. *See Tallahassee Memorial*

Regional Medical Center v. Bowen, 815 F.2d 1435, 1454 n.38, 1455 & n.41, 1456 (11th Cir. 1987), *petition for cert. filed*, No. 87-380;[7] *Mason General Hospital v. Secretary of Department of Health and Human Services*, 809 F.2d 1220, 1225 (6th Cir. 1987); *Albany General Hospital v. Heckler*, 657 F. Supp. 87, 92 (D. Or. 1987), *appeal docketed*, No. 87-3688.

c. The Secretary appears to suggest that the 1984 retroactive wage index rule was not truly retroactive because the invalidated 1981 rule provided respondents with "ample notice" of the cost limits ultimately adopted in 1984. Pet. at 17. The Secretary ignores that the effect of *DCHA* was to invalidate the 1981 rule "*ab initio.*" *DCHA*, App. at 63a; *see also* App. at 37a. As the *DCHA* court pointed out (App. at 60a), that result is mandated by the APA, which provides that a "reviewing court *shall* . . . hold unlawful and *set aside* agency action . . . found to be . . . without observance of procedure required by law." 5 U.S.C. § 706 (emphasis added). Thus, there is no basis for the Secretary's facile assumption that the respondents should have relied on the *invalid* 1981 wage index rule, which they challenged in court (with eventual success), rather than the *valid* 1979 wage index rule.[8] Respondents could hardly have anticipated that the Secretary would attempt to deprive them of the fruits of their victory through a wholly unprecedented retroactive rulemaking and recoupment process.

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[7] The *Tallahassee* court aptly noted:

> In football, if a team gains ten yards on a play in which it commits a five yard penalty, the ball is typically taken back to the original line of scrimmage and the five yard penalty is counted off from there. Adopting the Secretary's approach would be like taking five yards off from the point where the play ended (and thus allowing the team a net five yards gain on a play in which it committed an infraction).

815 F.2d at 1455 n.41.

[8] This is particularly true because the 1981 wage index was patently invalid. The *DCHA* court found that the Secretary's invocation of the "good cause" exemption in publishing the 1981 wage index rule without prior notice and comment procedures "does not survive even deferential scrutiny," much less the strict scrutiny normally applied in this circumstance. App. at 58a. The Secretary essentially argued that "mere incantation" by the agency was sufficient to trigger the "good cause" exemption. *Id.*

Moreover, entirely aside from its invalidity, the original 1981 rule did not furnish the respondents with "ample notice." The rule was published without any advance notice on June 30, 1981, to become effective the next day, thereby violating not only the APA's notice and comment requirements, but also the APA's thirty day delayed effective date requirement (5 U.S.C. § 553(d)). Like other business entities, hospitals operate under established labor and supply contracts that generally cannot be terminated at will. Significantly, the Secretary had recognized in the past that "accommodation to a lower cost level may require adjustment of staff schedules and purchasing practices that is hard to accomplish quickly" and had allowed *one or two year* grace periods to allow hospitals sufficient time to effect such adjustments before applying significant new cost limit rules. 43 Fed. Reg. 25,873 (1978), J.A. at 84; *see also* 41 Fed. Reg. 36,992 (1976); 44 Fed. Reg. 46,949-46,950 (1979). The Secretary's assertion that the one day's prior notice furnished by the *invalid* 1981 schedule was "ample" is patently absurd.

2. Section 223(b) of the 1972 Social Security Amendments amended section 1861(v)(1)(A) of the Social Security Act, 42 U.S.C. § 1395x(v)(1)(A), to authorize the Secretary to establish limits on hospital costs "*to be recognized* as reasonable. . . ." App. at 70a (emphasis added). The emphasized language plainly requires the Secretary to establish the limits before the beginning of the period to which they apply. That is confirmed by the legislative history. In identical language, both the House and Senate reports specify that the cost limits set thereunder must be "exercised on a *prospective, rather than retrospective, basis* so that the provider would know *in advance* the limits to Government recognition of incurred costs and have the opportunity to act to avoid having costs that are not reimbursable." H.R. Rep. No. 92-231, 92d Cong., 1st Sess. 83 (1971), J.A. at 71 (emphasis added); S. Rep. No. 92-1230, 92d Cong., 2d Sess 188 (1972), J.A. at 75 (emphasis added). Both reports repeat that "the limits would be defined in advance. . . ." House Rep. at 84, J.A. at 72; Sen. Rep. at 188, J.A. at 75.

The Secretary has consistently recognized that section 223(b) authorizes only "prospective" limits. His original cost limit regulation expressly stated: "These limits will be imposed

prospectively. . . ." 20 C.F.R. § 405.460(a) (1974) (emphasis added), *published at* 39 Fed. Reg. 20,165 (1974).[9] Five years later, the Secretary added the following language:

> *Prior to the beginning of a cost period to which limits will be applied,* the Secretary will publish a notice in the *Federal Register,* establishing cost limits and explaining the basis on which they were calculated.

42 C.F.R. § 405.460(b)(3) (1979) (emphasis added), *published at* 44 Fed. Reg. 31,804 (1979). The present cost limit regulation retains both of these provisions requiring prospective application.[10] *See* 42 C.F.R. § 413.30(a)(2), (b)(3) (App. at 71a).

In addition, the preamble of each proposed and final schedule of routine cost limits ever published by the Secretary has specified that section 223(b) allows the imposition of "prospective limits" on the costs reimbursable under Medicare.[11] Ironically, even the 1984 proposed notice for the

[9] The subsection (a) prospectivity language was omitted when the regulation was revised in 1979, but was restored in 1982. The 1982 preamble explains:

> We are amending 42 CFR 405.460(a) . . . by adding a sentence . . . setting forth the general principle . . . that the limits . . . will be applied on a prospective basis. When we revised the regulations . . . [in 1979], reference to the prospectivity of the limits was inadvertently omitted. *We are now inserting language in the regulation to make it clear that the limits are to be applied prospectively.*

47 Fed. Reg. 43,286 (col. 1) (1982) (emphasis added).

[10] The Secretary purported to publish his 1984 retroactive wage index rule pursuant to the principles in his cost limit regulation (then codified as 42 C.F.R. § 405.460). *See* 49 Fed. Reg. 6,180 (col. 1) (1984) (proposed notice); 49 Fed. Reg. 46,501 (col. 2) (1984) (final notice). *Thus, the Secretary's retroactive cost limit rule was issued pursuant to a cost limit regulation that prohibits retroactive cost limit rules.*

[11] *See* 39 Fed. Reg. 10,313 (Mar. 19, 1974); 39 Fed. Reg. 20,168 (June 6, 1974); 40 Fed. Reg. 17,190 (Apr. 17, 1975); 40 Fed. Reg. 23,622 (May 30, 1975); 41 Fed. Reg. 18,465 (May 4, 1976); 41 Fed. Reg. 26,992 (June 30, 1976); 42 Fed. Reg. 40,948 (Aug. 12, 1977); 42 Fed. Reg. 53,675 (Oct. 3, 1977); 43 Fed. Reg. 25,869 (June 15, 1978); 43 Fed. Reg. 43,559 (Sept. 26, 1978); 44 Fed. Reg. 11,612 (Mar. 1, 1979); 44 Fed. Reg. 31,806 (June 1, 1979); 45 Fed. Reg. 21,582 (Apr. 1, 1980); 45 Fed. Reg. 41,868 (June 20, 1980); 46 Fed. Reg. 7,456 (Jan. 23, 1981); 46 Fed. Reg. 33,637 (June 30, 1981); 46 Fed. Reg. 48,010 (Sept. 30, 1981).

Secretary's retroactive wage index rule accurately stated that section 223(b) authorizes "*prospective* limits." 49 Fed. Reg. 6,176 (col. 1) (1984) (emphasis added).

The Secretary's consistent position is also reflected in his administrative decisionmaking. For example, in *Beth Israel Hospital v. Blue Cross Association*, CCH Medicare and Medicaid Guide ¶ 31,645 at 10,137 (Nov. 7, 1981) (J.A. at 78-83), the Secretary (through his delegate, the Deputy Administrator of the Health Care Financing Administration) held that "prospectivity requires" that "[t]he criteria for setting the limits and the limits themselves . . . be established for all categories prior to the cost reporting period."

Based on a review of the foregoing authorities, the court of appeals very appropriately noted that "we are astonished that the Secretary now purports to have the authority to promulgate [cost limit] rules on a retroactive basis." App. at 16a.

The Secretary's 1984 retroactive wage index rule significantly reduced respondents' Medicare cost limits for their *1981* years. A rule that reduces reimbursement for a period that began more than three years prior to its issuance cannot be considered "prospective." Accordingly, the Secretary's retroactive wage index rule plainly exceeds the Secretary's authority under section 223(b) and is therefore invalid.[12]

3. In his petition, the Secretary argues that the 1984 retroactive wage index rule was authorized by the retroactive corrective adjustments provision (42 U.S.C. § 1395x (v)(1)(A)(ii)). The Secretary never made any such contention during the rulemaking proceedings.[13] The contention is strictly a *post hoc* rationalization of the Secretary's counsel.[14]

[12] The preamble to the final retroactive wage index rule includes *no* response to the respondents' comment that § 223(b) precludes the Secretary from issuing a retroactive cost limit rule. *See* Rulemaking Record ("Rec.") at 143-144. This is one of several reasons why the Secretary's "basis and purpose" statement was inadequate. *See* § 7 below.

[13] The Secretary stated that he was acting pursuant to § 223(b) (49 Fed. Reg. 6,176 (col. 1) (1984)) and purported to justify issuance of the retroactive wage index rule on "substantial legal authority" applicable to all agencies (49 Fed. Reg. 46,497 (col. 2) (1984)).

[14] The court of appeals held that the Secretary's reliance on the retroactive corrective adjustments provision must fail because he raised that

(footnote continues)

With respect to *cost limit* rules, the very general retroactive corrective adjustments provision must be construed in light of the more specific language added by section 223(b). Prior to 1972, the Secretary had no authority to issue *any* Medicare *cost limit* rules, prospective or retrospective. The only provision that grants him the authority to issue such rules is section 223(b). Yet, as discussed above, section 223(b) clearly prohibits the issuance of retroactive cost limit rules. Obviously, the retroactive corrective adjustments provision could not authorize the Secretary to issue retroactive cost limit rules when the only statutory authority for the issuance of cost limit rules prohibits the Secretary from issuing them retroactively. As the Secretary concedes, the retroactive corrective adjustments provision "does not override other provisions of the Medicare Act." Pet. at 17 n.10. Thus, even if the Secretary's broad *post hoc* construction of the retroactive corrective adjustments provision were correct, it would not change the result here because of the special considerations applicable to section 223(b) rules.

But it is clear that the *post hoc* construction of the Secretary's counsel is not correct. The provision does not authorize the Secretary to issue retroactive rules. Instead, it *requires* the Secretary to establish regulations that "provide *for the making of* retroactive corrective adjustments. . . ." App. at

(footnote continued)

issue for the first time in litigation. App. at 16a. (The court also, however, addressed and rejected the Secretary's contention on the merits. *See* App. at 16a-19a.) In reaching this conclusion, the court of appeals relied on the explicit APA requirements that (1) notice of proposed rules contain "reference to the legal authority under which the rule is proposed" (5 U.S.C. § 553(b)(2)) and (2) final rules include "a concise general statement of their basis and purpose" (5 U.S.C. § 553(c)). In his petition, the Secretary cites four cases which, he claims, support the proposition that an agency may rely in court on a legal basis not asserted by the agency at the time of the challenged action. Pet. at 16 n.9. However, none of these cases involved an agency's belated attempt to justify a rule published under APA notice and comment rulemaking procedures. Significantly, in *Baylor University Medical Center v. Heckler*, 758 F.2d 1052, 1060 (5th Cir. 1985), a case relied upon by the Secretary, the Fifth Circuit stated that, where APA notice and comment procedures are required, the "goals" of the APA would be "frustrated" if courts "allowed an administrative agency to rely on reasons for past action that it was unable or unwilling to articulate at the time the action was taken."

69a-70a (emphasis added). In other words, Congress ordered the Secretary to issue a regulation that establishes *a process* for making certain "adjustments." "Adjustments," of course, are normally made to "reimbursement" or payments, not regulations. Moreover, these particular "adjustments" are to be made "where, *for a provider of services for any fiscal period, the aggregate reimbursement* produced by the methods of determining costs *proves to be* either *inadequate or excessive.*" *Id.* at 70a (emphasis added). Thus, to properly make the adjustments, the Secretary must determine a *particular provider's* "aggregate reimbursement" for a *particular period* and then determine whether that "aggregate reimbursement" was "inadequate or excessive." *Id.* The Secretary can obviously do that only on a case-by-case basis. Thus, the Secretary's *post hoc* suggestion that this provision authorizes the promulgation of retroactive rules of general applicability conflicts with the plain wording of the provision.

The Secretary has, in fact, *never* published any regulation that has set up a process for issuing retroactive rules.[15] He has, however, published regulations that have set up a process for making retroactive adjustments on a case-by-case basis. These regulations, which date from 1966, require the Secretary's agents to make retroactive adjustments for each provider to reconcile the amount to which the provider is entitled after a full audit with the amount of estimated payments received by the provider during the year. *See* 42 C.F.R. § 413.64(a)(1), (b), (f) (App. at 71a-73a); 42 C.F.R. § 413.9 (App. at 70a-71a). Thus, the Secretary's broad *post hoc* construction of the retroactive corrective adjustments provision is contradicted by his own regulations.

It also conflicts with the construction adopted by the agency near the time of the provision's enactment. In congressional hearings held in 1966, Robert M. Ball, then Commissioner of the Social Security Administration (the agency originally responsible for administering the Medicare program),

[15] The retroactive corrective adjustments provision is phrased in mandatory language. Thus, if the Secretary's broad *post hoc* construction of the provision is correct, the Secretary has been in violation of the law for the past twenty-two years.

stated that the provision does not authorize the agency to change reimbursement rules retroactively and construed the provision, consistent with the regulations issued shortly thereafter, as simply requiring a year-end reconciliation based on the results of a final audit.[16] *See Mason General Hospital,* 809 F.2d at 1225-1226; *Daughters of Miriam Center for the Aged v. Mathews,* 590 F.2d 1250, 1258-1259 n.23 (3d Cir. 1978). An agency's contemporaneous construction is, of course, entitled to considerable deference. *General Electric Co. v. Gilbert,* 429 U.S. 125, 142 (1976). Thus, even outside the section 223(b) context involved here, there is no merit to the broad *post hoc* construction of the retroactive corrective adjustments provision presented in the Secretary's petition.[17]

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[16] Commissioner Ball testified:

> Payments [to Medicare providers] will be made for services throughout the year and final settlement on a retroactive basis will be made at the end of the accounting period. Continuing payments will be made as often as possible and in no event less frequently than once a month. The retroactive payments will take fully into account costs as they were actually incurred, *determined according to the agreed upon principles of reimbursement—we don't retroactively change the principles*—and settlement will be on an incurred rather than on an estimated basis.

Reimbursement Guidelines for Medicare, Hearings Before the Senate Committee on Finance, 89th Cong., 2d Sess. 56 (1966) (emphasis added).

> *I don't think that the retroactive provision contemplates going back over the year and changing the principles.*
>
> • • • •
>
> It would hardly seem reasonable at the end of the year, after hospitals had entered into an agreement with you on the basis of certain principles, to shift all the principles for retroactive settlement in terms of how you compute a cost. *I don't think that was contemplated at all.*

Id. at 119 (emphasis added).

[17] In *Heckler v. Community Health Services of Crawford County, Inc.,* 467 U.S. 51, 53-54 (1984), this Court adopted the same construction of the retroactive corrective adjustments provision contained in the Secretary's regulations and reflected in Commissioner Ball's congressional testimony:

> Providers receive interim payments at least monthly covering the cost of services they have rendered. [42 U.S.C.] § 1395g(a). Congress recognized, however, that these interim payments would not always correctly reflect the amount of reimbursable costs, and accordingly instructed the Secretary to develop mechanisms for making appropriate retroactive adjustments when reimbursement is found to be inadequate or excessive. § 1395x(v)(1)(A)(ii).

4. The D.C. Circuit's decision is not in conflict with the decision of any other appellate court. No other appellate court has considered the validity of the Secretary's 1984 retroactive wage index rule.[18] Nor does the D.C. Circuit's decision conflict in principle with the decision of any other appellate court. No appellate court has *ever* held that the Secretary may promulgate a retroactive *cost limit* rule.[19]

The closest analogy to the Secretary's 1984 retroactive wage index rule is the Secretary's 1986 rule governing the apportionment of malpractice costs. The Secretary published the 1986 malpractice rule after literally scores of courts invalidated his 1979 malpractice rule and ordered payment under the preexisting rule.[20] To date, all nine courts that have considered the issue have refused to allow the Secretary to apply the 1986 malpractice rule retroactively. *See Mason General Hospital; Tallahassee Memorial Regional Medical Center; St. Peter's Medical Center v. Heckler,* 813 F.2d 398 (3d Cir. 1987); *Albany General Hospital; Miami General Hospital v. Bowen,* 652 F. Supp. 812 (S.D. Fla. 1986); *West Anaheim Community Hospital v. Bowen,* CCH Medicare and Medicaid

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[18] In *Leila Hospital and Health Center v. Bowen,* 661 F. Supp. 394 (W.D. Mich. 1987) and 661 F. Supp. 397 (W.D. Mich. 1987), *appeal docketed,* No. 87-1202, the court upheld the validity of the 1984 retroactive wage index rule under the facts of that case. However, unlike the respondents, the *Leila* plaintiff did not obtain a court judgment invalidating the 1981 rule, receive payment under the preexisting 1979 rule, suffer recoupment under the 1984 rule, or attack the substantive validity of the 1984 rule. The *Leila* court noted that it agreed with the district court's judgment in the instant case, but concluded that it was faced with "a different case, with different facts that require a different result." 661 F. Supp. at 406.

[19] The only cases cited by the Secretary that even arose in the context of the Secretary's cost limits are *Regents of the University of California v. Heckler,* 771 F.2d 1182 (9th Cir. 1985), and *St. Paul-Ramsey Medical Center v. Bowen,* 816 F.2d 417 (8th Cir. 1987). Neither case involved an attempt by the Secretary to apply a cost limit rule retroactively. Both courts construed the retroactive corrective adjustments provision as requiring the Secretary to make an adjustment where, *in a particular case,* an individual provider *proves* that the Secretary's reimbursement methods result in inadequate payment. That construction is entirely consistent with the construction of the D.C. Circuit in this case. *See* App. at 16a-19a.

[20] The appellate court decisions reaching this result are listed in *Mason General Hospital,* 809 F.2d at 1223 n.2. As noted there, this Court denied the Secretary's petitions for *certiorari* in all three cases in which they were filed.

Guide ¶ 36,609 (C.D. Cal. July 13, 1987), *appeal docketed,* No. 87-6391; *St. Joseph's Hospital v. Bowen,* CCH Medicare and Medicaid Guide ¶ 36,437 (D. Ariz. April 15, 1987), *appeal docketed,* No. 87-2338; *Bethesda Community Hospital v. Heckler,* CCH Medicare and Medicaid Guide ¶ 36,654 (S.D.N.Y. Aug. 5, 1987); *Childrens Hospital of San Francisco v. Bowen,* CCH Medicare and Medicaid Guide ¶ 36,679 (E.D. Cal. Sep. 3, 1987), *appeal docketed,* No. 87-2957.

The case against the Secretary is much stronger here. Unlike the 1984 retroactive wage index rule, the 1986 malpractice rule is *not* a cost limit rule and thus is not subject to the express prospectivity requirement established by section 223(b). Moreover, the Secretary has not attempted to apply the 1986 malpractice rule to recoup any monies paid as a result of prior court judgments (as he has done here) and has even strongly implied that it would be unlawful for him to do so. *See* 51 Fed. Reg. 11,149 (col. 3), 11,186 (cols. 2 and 3), and 11,187 (col. 2) (1986) ("Adoption of this final rule is not unlawful since all final, non-appealable judgments mandating . . . reimbursement [under the rule in effect before 1979] will be complied with.").

Most of the other Medicare cases cited by the Secretary's petition involve the Secretary's recapture of accelerated depreciation regulation, *which also was not a cost limit regulation.* The recapture regulation was primarily prospective and had only incidental retroactive effect. The Secretary validly announced the rule six months before it became effective. A provider could have avoided recapture by withdrawing from the program during that period. After the rule became effective, a provider could have avoided application of the rule by simply remaining in the program until all assets subject to accelerated depreciation were fully depreciated. The rule affected only those providers that chose to withdraw from the Medicare program *after* the effective date of the new rule but *before* the assets subject to accelerated depreciation were fully depreciated. The courts upholding the Secretary's regulation focused closely on its very limited retroactivity. *Springdale Convalescent Center v. Mathews,* 545 F.2d 943, 956 (5th Cir. 1977) ("The retroactive portion of the Secretary's regulation is narrowly drawn."); *Hazelwood Chronic and Convalescent Hospital, Inc. v. Weinberger,* 543 F.2d 703, 708 (9th Cir. 1976),

vacated and remanded on other grounds, 430 U.S. 952 (1977) ("The retroactive effects of the instant regulation were limited and reasonable."); *Adams Nursing Home of Williamstown, Inc. v. Mathews,* 548 F.2d 1077, 1080 n.8 (1st Cir. 1977); *Fairfax Nursing Center, Inc. v. Califano,* 590 F.2d 1297, 1302 (4th Cir. 1979).

The Secretary relies primarily on the *Springdale* case for a broad construction of the retroactive corrective adjustments provision. Pet. at 13. However, the Eleventh Circuit, which is bound by 1977 Fifth Circuit precedent,[21] recently construed *Springdale* much more narrowly than the Secretary, emphasizing that the *Springdale* court was addressing a regulation that was "predominantly prospective in nature." *Tallahassee,* 815 F.2d at 1454 n.37; *see also Mason General,* 809 F.2d at 1225-1227. In contrast, the instant case involves a rule that is entirely retroactive. The 1984 retroactive wage index rule was issued in November 1984 to be applicable solely to cost reporting years beginning in the period July 1, 1981—September 30, 1982. The Secretary has cited no Medicare court case (or any other court case, for that matter) that has tolerated retroactivity of this nature.

5.a. This case has virtually no practical significance. The rule at issue was entirely retroactive even when published in 1984 and thus obviously has no current applicability in 1988. Moreover, it appears that only one other hospital in the country is challenging the Secretary's retroactive wage index rule—and it is doing so under significantly different circumstances. *See Leila Hospital and Health Center v. Bowen.*

The question whether section 223(b) bars the promulgation and application of a retroactive cost limit rule also has virtually no current relevance. With the exception of the 1984 retroactive rule involved here, the last time that the Secretary established section 223(b) limits *applicable to hospitals* was in 1982, and those limits applied only to cost reporting years beginning in the period October 1, 1982-September 30, 1983.

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[21] *See Bonner v. City of Pritchard, Alabama,* 661 F.2d 1206, 1207 (11th Cir. 1981) (holding that the Eleventh Circuit is bound by Fifth Circuit decisions issued before the Eleventh Circuit came into existence).

See 47 Fed. Reg. 43,282 (1982). *No* hospital in the country has been subject to *any* section 223(b) limits for *any* costs for *any* cost reporting year beginning after September 30, 1983.[22]

It is true that the Secretary has continued to promulgate and apply section 223(b) cost limits to home health agencies and skilled nursing facilities. However, home health agencies and skilled nursing facilities account for only slightly more than four percent of total Medicare expenditures.[23] *No* section 223(b) cost limits are applicable to the remaining ninety-six percent.

b. Despite considerable effort, respondents have found no evidence to support the Secretary's bald assertion that "many" pending cases "involve challenges to the Secretary's authority to promulgate retroactive cost limit regulations." Pet. at 24 n.15. Respondents have found only one other pending court case involving this issue—*Leila Hospital,* discussed above.[24] Given that the Secretary has generally faithfully adhered to the prospectivity requirement of section 223(b) and that no section 223(b) cost limits have been applicable to hospitals for nearly five years, respondents can discern no reason why there should

[22] The Secretary correctly notes that some hospitals are exempt from the new prospective payment system ("PPS") and that even hospitals subject to PPS continue to be paid on a modified cost basis for certain costs. Pet. at 23-24. However, the Secretary fails to point out that there are *no* section 223(b) limits applicable to any exempt hospitals or exempt hospital costs, nor have there been any since October 1, 1983.

[23] According to the most recent *published* figures which respondents were able to find, home health agencies and skilled nursing facilities accounted for 3.4% of total Medicare expenditures in 1983. *See* Gornick, Greenberg, Eggers & Dobson, *Twenty Years of Medicare and Medicaid: Covered Populations, Use of Benefits, and Program Expenditures,* Health Care Financing Rev. 13, 43 (Supp. 1985). However, respondents have been advised that home health agencies and skilled nursing facilities accounted for approximately 4.3% of total Medicare expenditures in 1986. Telephone interview with Dick Lyman, Branch Chief, HCFA Statistical Services (Jan. 25, 1988) (citing Office of the Actuary, Division of Medicare, Estimated Hospital Insurance Disbursements (1987) and Medical Insurance Disbursements (1987) (cost estimates for calendar year 1986)).

[24] Hundreds of hospitals are challenging the validity of the Secretary's 1986 retroactive malpractice rule, discussed above. However, it is a cost apportionment, not a cost limit, rule. It was not published under the authority of § 223(b) and does not implicate § 223(b) in any way.

be any—much less many—other court cases involving this question. Absent supporting documentation, the Secretary's assertion should be disregarded.

6.a. This is not an appropriate case for resolving the APA question raised by the Secretary. Because section 223(b) clearly barred promulgation of the 1984 retroactive wage index rule, the Court need not reach the issue whether the APA *also* barred promulgation of the rule.[25] However, assuming that this question is considered, the APA also requires invalidation of the Secretary's rule.

The APA clearly establishes a general rule against the promulgation of retroactive rules. It defines a rule as "an agency statement of . . . *future effect*" which "includes the approval or prescription *for the future*" of certain matters. 5 U.S.C. § 551(4) (emphasis added), App. at 67a.[26] Statements of the legislation's sponsors[27] and passages from the

[25] The Secretary acknowledges that the "threshold inquiry is whether the substantive statute granting rulemaking authority imposes any restriction upon the agency's authority to apply rules retroactively." Pet. at 21. The answer to that inquiry here is an unequivocal yes: § 223(b) plainly prohibits the Secretary from promulgating a retroactive cost limit rule. Thus, § 223(b) is dispositive of this case, and there is no need to reach the APA issue.

[26] The Secretary argues that the APA definition simply means that "any application or enforcement will occur *only in the future, i.e.,* in an adjudication." Pet. at 19 (original emphasis). Aside from conflicting with the plain wording of the statutory provision, the Secretary's construction is contradicted by what happened here. The Secretary enforced his 1984 retroactive wage index rule without the benefit of "an adjudication"; he simply recouped from the respondents' Medicare payments the amounts previously paid under *DCHA.*

[27] *See* Proceedings from the Congressional Record, *Legislative History of the Administrative Procedure Act, 1944-1946,* at 355 ("In rule making an agency is not telling someone what his rights or liabilities are for past conduct or present status under existing law. Instead, in rule making the agency is prescribing what the future law shall be so far as it is authorized so to act.") (remarks of Congressman Francis E. Walter); *id.* at 374 ("[The bill] requires that . . . rules or regulations which have the effect of law must . . . go into effect at some future date.") (remarks of Congressman John W. Gwynne).

Attorney General's Manual on the APA [28] confirm that Congress meant exactly what it said. So does a decision of this Court issued one year after the APA was enacted. *See SEC v. Chenery Corp.*, 332 U.S. 194, 202 (1947) ("Since the Commission, unlike a court, does have *the ability to make new law prospectively through the exercise of its rule-making powers,* it has less reason to rely upon ad hoc adjudication to formulate new standards of conduct.... The function of filling in the interstices of the Act should be performed, as much as possible, through this *quasi-legislative promulgation of rules to be applied in the future.*" (Emphasis added.)).

The Secretary cites a passage from the report of the House Judiciary Committee which states that "[t]he phrase 'future effect' does not preclude agencies from considering and, so far as legally authorized, dealing with past transactions in prescribing rules for the future." Pet. at 20. However, that passage supports respondents, not the Secretary. "[D]ealing with past transactions in prescribing rules for the future" is different from prescribing rules for the past. It is the latter type of rule that is involved in this case and which is generally prohibited by the APA.

The Secretary also relies on the following passage in the *Attorney General's Manual on the APA:* "Nothing in the Act precludes the issuance of retroactive rules when otherwise legal and accompanied by the finding [of good cause] required by [5 U.S.C. § 553(d)]. H.R. REP. p. 49, fn.1 (Sen. Doc. p. 283)." *Manual* at 37. However, that passage expressly cites as authority the passage from the House Report examined in the preceding paragraph of this brief. Thus, the Attorney General was simply using the term "retroactive rules" loosely to describe rules that deal with past transactions in prescribing standards for the future. This is confirmed by other passages in the *Manual* that clearly reflect that the Attorney General did not believe that the APA allows an agency to prescribe rules for the past. *See* note 28 above. The passage cited by the Secretary does not, in any event, help the Secretary here because the Secretary's 1984 retroactive wage index rule was not accompanied by a "good cause" finding (*see* 49 Fed. Reg. 46,495 (1984)) and, as the court of appeals expressly found, does not come "within any conceivable 'good cause' exception" (App. at 12a n.11).

[28] *See* Justice Department, *Attorney General's Manual on the Administrative Procedure Act* 13 (1947) ("Of particular importance is the fact that 'rule' includes agency statements not only of general applicability but also those of particular applicability applied either to a class or to a single person. In either case, they must be of *future effect,* implementing or prescribing future law." (original emphasis)); *id.* at 14 ("Rule making is agency action which regulates the future conduct of either groups of persons or a single person; it is essentially legislative in nature, not only because it operates in the future but also because it is primarily concerned with policy considerations. The object of the rule making proceeding is the implementation or prescription of law or policy for the future, rather than the evaluation of a respondent's past conduct."); *id.* at 28 ("[5 U.S.C. § 553(d)] is not intended to hamper the agencies in cases in which there is good cause for putting a rule into effect immediately, or at some time earlier than thirty days.").

b. The APA does not expressly provide any exceptions to the "general rule" requiring that agency rules be of "future effect." [29] However, even if exceptions are appropriate in certain cases, this is not one of them for several reasons:

(1) The 1984 wage index rule retroactively rescinded the 1979 wage index rule, which had been duly promulgated in accordance with APA notice and comment procedures. The 1984 rule was thus not promulgated to fill a void.

(2) The Secretary promulgated the 1984 retroactive wage index rule to reverse *DCHA*.

(3) The Secretary applied the 1984 retroactive wage index rule to recoup from the respondents over $2.5 million that they had received as a result of *DCHA*.

(4) The 1984 retroactive wage index rule is totally devoid of "future effect." It applies solely to cost reporting years beginning in a fifteen month period that closed more than two years before the 1984 rule was even promulgated.

[29] 5 U.S.C. § 553(d)(3) allows an exception to the normal thirty day delayed effective date requirement "for good cause found and published with the rule." However, construed literally, the exception only allows an agency to make a rule effective immediately or in less than thirty days, not retroactively.

(5) The Secretary did not even attempt to invoke a "good cause" exception when he published the retroactive wage index rule. *See* 49 Fed. Reg. 46,495 (1984). Moreover, the court of appeals expressly found that "the reasons advanced by the Secretary in his notice for promulgating" the rule "plainly do not bring [it] within any conceivable 'good cause' exception." App. at 12a n.11.

The court of appeals' APA holding does not conflict in principle with the holding of any other appellate court.[30] None of the cases cited by the Secretary (Pet. at 18-19) involves any of the five circumstances discussed in the preceding paragraph. Indeed, none of the rules in the cases cited by the Secretary was even primarily retroactive. To the extent that the cases involved retroactivity at all, it was retroactivity incidental to a predominantly prospective rule.[31]

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[30] The Secretary has mischaracterized the court of appeals' APA holding throughout his petition. *See, e.g.*, Pet. at 18 (stating that the court's determination "rests on the novel conclusion that the APA prohibits virtually all retroactive rulemaking. . . ."). The court's exact words were:

> Appellant characterizes our opinion as holding that the Administrative Procedure Act imposes a "per se" ban on retroactive rulemaking. As a general rule, the APA requires that legislative rules be given future effect only. Whatever exceptions might exist to this general rule were not implicated in the case before us. Our opinion therefore does not purport to address circumstances in which there may be an exception to the rule against retroactive rulemaking.

App. at 45a.

[31] Courts have sometimes loosely characterized as "retroactive" rules that have an impact upon preexisting interests. For example, in *General Tel. Co. v. United States*, 449 F.2d 846 (5th Cir. 1971), one of the cases relied on by the Secretary (Pet. at 19), the Federal Communications Commission adopted a rule prohibiting telephone companies from furnishing cable television services. The rule was applied prospectively; however, its effect was to require some companies to divest their cable television services. Thus, the rule had an incidental "retroactive" effect in that it modified preexisting interests. This type of "retroactive" rule, however, is hardly analogous to the Secretary's retroactive wage index rule, which has no prospective application, but operates wholly retroactively.

c. The court of appeals' conclusion that the invalidation of an agency rule generally has the effect of leaving in place the preexisting rule (App. at 13a) is in accord with the conclusions of other circuits. *See, e.g., Mason General Hospital*, 809 F.2d at 1223, 1229; *Tallahassee Memorial Regional Medical Center*, 815 F.2d at 1453 n.35, 1455-1456; *Abington Memorial Hospital v. Heckler*, 750 F.2d 242, 244 (3d Cir. 1984), *cert. denied*, 106 S. Ct. 180 (1985); *Lloyd Noland Hospital and Clinic v. Heckler*, 762 F.2d 1561, 1569 (11th Cir. 1985); *Menorah Medical Center v. Heckler*, 768 F.2d 292, 297 (8th Cir. 1985); *Cumberland Medical Center v. Secretary of Health and Human Services*, 781 F.2d 536, 538-539 (6th Cir. 1986); *DeSoto General Hospital v. Heckler*, 766 F.2d 182, 186, *modified on rehearing*, 766 F.2d 186, *original opinion reinstated on rehearing of rehearing*, 776 F.2d 115, 116 (5th Cir. 1985); *Action on Smoking and Health v. CAB*, 713 F.2d 795, 797 (D.C. Cir. 1983). The three decisions of this Court on which the Secretary relies (Pet. at 20) all involved, as the Sixth Circuit has noted, special circumstances justifying a departure from the general rule, which circumstances are not present in the instant case. *See Cumberland*, 781 F.2d at 538.

The court of appeals' conclusion regarding the effect of invalidation simply reaffirmed what the *DCHA* court had held more than four years earlier. If the Secretary was not prepared to accept that holding, he should have appealed *DCHA*. The principle of *res judicata* now precludes him from attempting to relitigate this issue against the respondents.

7. It is not necessary for the Court to address either of the two questions raised by the Secretary. The district court did not rule on these questions. Instead, it ruled in respondents' favor based on the balancing test generally applied to retroactive agency rules adopted in adjudication, *i.e.*, it found that the inequity of applying the Secretary's retroactive rule to the respondents far exceeded any statutory interest underlying the rule.

In its analysis, the district court also strongly implied agreement with (1) respondents' contention that the Secretary's rule violates the Medicare statute's "reasonable cost" reimbursement mandate ("application of the reissued wage

index rule to these plaintiffs would have resulted in under-reimbursement of legitimate costs—which would contravene the purposes of the Medicare statutes." App. at 36a); (2) respondents' contention that the rule is arbitrary and capricious because the Secretary failed to take into account relevant factors ("the Secretary has in this case failed to confront with sufficient particularity . . . the effect of area differentials and *relevant* labor markets on average hospital wage levels." App. at 37a (original emphasis)); (3) respondents' contention that the Secretary failed to publish an adequate "basis and purpose" statement ("the notice and comment 'procedural correction' was in critical respects simply *pro forma.*" App. at 38a); and (4) respondents' contention that the rule violated the APA's thirty day delayed effective date requirement ("the Secretary's action does appear to violate 5 U.S.C. § 553(d)'s requirement that rules must have a thirty day delayed effective date." App. at 33a).

The nature of an opposition brief precludes an extended discussion of the substantive defects in the Secretary's rule, but one point in particular should be noted. The Secretary's retroactive wage index rule is based on the assumption that a metropolitan statistical area ("MSA") constitutes a homogeneous economic unit. However, as respondents pointed out in their public comments (*see* Rec. at 96-141, 152-153), that assumption is mistaken. For instance, the District of Columbia MSA includes Calvert, Charles, Frederick, and Montgomery Counties, Maryland, and Fairfax County, Fairfax City, Loudoun County, Manassas City, Manassas Park City, Prince William and Stafford Counties, Virginia—an area extending all the way to West Virginia to the West, Pennsylvania to the North, the Chesapeake Bay to the East, and more than halfway to Richmond to the South. Rec. at 152. Labor costs are much lower in Loudoun, Prince William, and Stafford Counties (all of which are largely rural) than in the District of Columbia. *Id.* at 124. The Secretary's retroactive wage index rule has removed from the applicable wage pool the high wages of the federal government hospitals with which District of Columbia hospitals must compete for employees, but has retained in the

wage pool the relatively low wages of distant suburban and rural hospitals with which the District of Columbia hospitals do not compete, thereby significantly lowering the wage index properly applicable to District of Columbia hospitals. That makes absolutely no sense and, as the district court found, results in the "under-reimbursement of legitimate costs—which . . . contravene[s] the purposes of the Medicare statutes." [32] *See* App. at 36a.

The two questions presented by the Secretary only scratch the surface of the questions raised by respondents below. The Secretary's rule is invalid on seven discrete grounds, any of which alone is sufficient to affirm the lower court judgment. Thus, if the Court were to hear this case, it might well never reach, as the district court did not reach, the two questions presented by the Secretary.

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[32] There is no basis whatsoever for the Secretary's assertion that application of the retroactive wage index rule was required to prevent the respondents from retaining a "windfall" or "excess reimbursement." Pet. at 22. Significantly, both courts below strongly disagreed with the Secretary's unsupported assertion. App. at 12a n.11, 18a-19a & n.16; *id.* at 36a-37a.

CONCLUSION

For the foregoing reasons, the Court should deny the Secretary's petition for a writ of *certiorari.*

Respectfully submitted,

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APPENDIX H

STATUTES AND REGULATIONS INVOLVED

1. 5 U.S.C. § 551(4)—

For the purpose of this subchapter—

• • • • •

(4) "rule" means the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency and includes the approval or prescription for the future of rates, wages, corporate or financial structures or reorganizations thereof, prices, facilities, appliances, services or allowances therefor or of valuations, costs, or accounting, or practices bearing on any of the foregoing.

2. 5 U.S.C. § 553(b)-(d)—

(b) General notice of proposed rule making shall be published in the Federal Register, unless persons subject thereto are named and either personally served or otherwise have actual notice thereof in accordance with law. The notice shall include—

(1) a statement of the time, place, and nature of public rule making proceedings;

(2) reference to the legal authority under which the rule is proposed; and

(3) either the terms or substance of the proposed rule or a description of the subjects and issues involved.

• • • • •

(c) After notice required by this section, the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation. After consideration of the relevant matter

presented, the agency shall incorporate in the rules adopted a concise general statement of their basis and purpose. . . .

(d) the required publication or service of a substantive rule shall be made not less than 30 days before its effective date, except—

(1) a substantive rule which grants or recognizes an exemption or relieves a restriction;

(2) interpretative rules and statements of policy; or

(3) as otherwise provided by the agency for good cause found and published with the rule.

3. 5 U.S.C. § 706—

To the extent necessary to decision and when presented, the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action. The reviewing court shall—

(1) compel agency action unlawfully withheld or unreasonably delayed; and

(2) hold unlawful and set aside agency action, findings, and conclusions found to be—

(A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;

(B) contrary to constitutional right, power, privilege, or immunity;

(C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right; [or]

(D) without observance of procedure required by law;

* * * * *

In making the foregoing determinations, the court shall review the whole record or those parts of it cited by a party, and due account shall be taken of the rule of prejudicial error.

4. 42 U.S.C. § 1395x(v)(1)(A) (Section 1861(v)(1)(A) of the Social Security Act)—

The reasonable cost of any services shall be the cost actually incurred, excluding therefrom any part of incurred cost found to be unnecessary in the efficient delivery of needed health services, and shall be determined in accordance with regulations establishing the method or methods to be used, and the items to be included, in determining such costs for various types or classes of institutions, agencies, and services. . . . In prescribing the regulations referred to in the preceding sentence, the Secretary shall consider, among other things, the principles generally applied by national organizations or established prepayment organizations (which have developed such principles) in computing the amount of payment, to be made by persons other than the recipients of services, to providers of services on account of services furnished to such recipients by such providers. Such regulations may provide for determination of the costs of services on a per diem, per unit, per capita, or other basis, may provide for using different methods in different circumstances, may provide for the use of estimates of costs of particular items or services, may provide for the establishment of limits on the direct or indirect overall incurred costs or incurred costs of specific items or services or groups of items or services to be recognized as reasonable based on estimates of the costs necessary in the efficient delivery of needed health services to individuals covered by the insurance programs established under this subchapter, and may provide for the use of charges or a percentage of charges where this method reasonably reflects the costs. Such regulations shall (i) take into account both direct and indirect costs of providers of services (excluding therefrom any such costs, including standby costs, which are determined in accordance with regulations to be unnecessary in the efficient delivery of services covered by the insurance programs established under this subchapter) in order that, under the methods of determining costs, the necessary costs of efficiently deliv-

ering covered services to individuals covered by the insurance programs established by this subchapter will not be borne by individuals not so covered, and the costs with respect to individuals not so covered will not be borne by such insurance programs, and (ii) provide for the making of suitable retroactive corrective adjustments where, for a provider of services for any fiscal period, the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive.

5. Pub. L. No. 92-603, § 223(b) (1972)—

The third sentence of section 1861(v)(1) of [the Social Security] Act is amended by striking out the comma after "services," where it last appears and inserting in lieu thereof the following: "may provide for the establishment of limits on the direct or indirect overall incurred costs or incurred costs of specific items or services or groups of items or services to be recognized as reasonable based on estimates of the costs necessary in the efficient delivery of needed health services to individuals covered by the insurance programs established under this title,".

6. 42 C.F.R. § 413.9(b)(1)—

(b) *Definitions*—(1) *Reasonable cost.* Reasonable cost of any services must be determined in accordance with regulations establishing the method or methods to be used, and the items to be included. The regulations in this part take into account both direct and indirect costs of providers of services. The objective is that under the methods of determining costs, the costs with respect to individuals covered by the program will not be borne by individuals not so covered, and the costs with respect to individuals not so covered will not be borne by the program. These regulations also provide for the making of suitable retroactive adjustments after the provider has submitted fiscal and statistical reports. The retroactive adjustment will represent the difference between the amount received by

the provider during the year for covered services from both Medicare and the beneficiaries and the amount determined in accordance with an accepted method of cost apportionment to be the actual cost of services furnished to beneficiaries during the year.

7. 42 C.F.R. § 413.30(a), (b)(3)—

(a) *Introduction*—(1) *Scope.* This section implements section 1861(v)(1)(A) of the Act, by setting forth the general rules under which HCFA may establish limits on provider costs recognized as reasonable in determining Medicare program payments. . . .

* * * * *

(2) *General principle.* Reimbursable provider costs may not exceed the costs estimated by HCFA to be necessary for the efficient delivery of needed health services. HCFA may establish estimated cost limits for direct or indirect overall costs or for costs of specific items or services or groups of items or services. These limits will be imposed prospectively and may be calculated on a a per admission, per discharge, per diem, per visit, or other basis.

(b) *Procedure for establishing limits.*

* * * * *

(3) Prior to the beginning of a cost period to which revised limits will be applied, HCFA will publish a notice in the Federal Register, establishing cost limits and explaining the basis on which they were calculated.

8. 42 C.F.R. § 413.64(a)(1), (b), (f)—

(a) *Principle*—(1) *Reimbursement on a reasonable cost basis.* Providers of services paid on the basis of the reasonable cost of services furnished to beneficiaries will receive interim payments approximating the actual costs of the provider. These payments will be made on the most expeditious schedule administratively feasible but not less

often than monthly. A retroactive adjustment based on actual costs will be made at the end of a reporting period.

* * * * *

(b) *Amount and frequency of payment.* Medicare states that providers of services will be paid the reasonable cost of services furnished to beneficiaries. Since actual costs of services cannot be determined until the end of the accounting period, the providers must be paid on an estimated cost basis during the year. While Medicare provides that interim payments will be made no less often than monthly, intermediaries are expected to make payments on the most expeditious basis administratively feasible. Whatever estimated cost basis is used for determining interim payments during the year, the intent is that the interim payments shall approximate actual costs as nearly as is practicable so that the retroactive adjustment based on actual costs will be as small as possible.

* * * * *

(f) *Retroactive adjustment.* (1) Medicare provides that providers of services will be paid amounts determined to be due, but not less often than monthly, with necessary adjustments due to previously made overpayments or underpayments. Interim payments are made on the basis of estimated costs. Actual costs reimbursable to a provider cannot be determined until the cost reports are filed and costs are verified. Therefore, a retroactive adjustment will be made at the end of the reporting period to bring the interim payments made to the provider during the period into agreement with the reimbursable amount payable to the provider for the services furnished to program beneficiaries during that period.

(2) In order to reimburse the provider as quickly as possible, an initial retroactive adjustment will be made as soon as the cost report is received. For this purpose, the costs will be accepted as reported, unless there are obvious errors or inconsistencies, subject to later audit. When an

audit is made and the final liability of the program is determined, a final adjustment will be made.

(3) To determine the retroactive adjustment, the amount of the provider's total allowable cost apportioned to the program for the reporting year is computed. This is the total amount of reimbursement the provider is due to receive from the program and the beneficiaries for covered services furnished during the reporting period. The total of the interim payments made by the program in the reporting year and the deductibles and coinsurance amounts receivable from beneficiaries is computed. The difference between the reimbursement due and the payments made is the amount of the retroactive adjustment.